January 4, 2018

Dear Clients and Friends:

As we begin a new year, global central banks, including our own Federal Reserve, continue to pursue the Platonic ideal of 2% inflation … just as they have for nearly 10 years. Never mind the ever-changing definition of inflation. The narrow focus on a single variable, usually a version of an imbedded deflator stripped of all inconvenient items, has allowed central banks to pursue what will ultimately be looked upon as reckless policies with impunity. Are we to believe that the effect of monetary policy on something as complex as the modern economy can be reduced to a single variable? Next, we will be told that climate science can be reduced to the single variant of the level of CO_2 in the atmosphere. Inconceivable!

We have been clear that despite the assurances of our esteemed central bankers, inflation is all around us in asset prices. The current bubble is not narrowly focused, like housing in 2007 or the NASDAQ in 2000. This time it is more broadly based … stocks/bonds/commodities/real estate … and, therefore, the risk of a likely policy mistake is much greater. The reason is an issue of time (nearly a decade) and magnitude (north of 10 trillion dollars). While our Fed has begun gradually reversing course, our friends in Europe and Japan continue to feed the insatiable appetite of the beast, monetizing debt faster than it can be created despite economies that have mended and, in fact, appear to be accelerating. This has been going on for years now and despite Cassandra-like warnings, there seems to have been no ill effect. We think this is likely to change.

As stated earlier, we believe the narrow focus on a seemingly immovable variable has allowed central banks the cover to do what they do. Picture a dog chasing a car in a seemingly endless loop. The central banks have been allowed to be as mindless as that dog since they never catch it. It has been going on for so long that most have lost interest. Did you ever stop to wonder what the dog would do if it caught the car? It is our belief that 2018 could be the year that the dog catches that car. Ten years of a single-minded monolithic policy could suddenly end. A sclerotic, bureaucratic organization could be required to change policy in rapid fashion. The single variable they have focused on will blossom into multiple variables as the scope and magnitude of the all-asset bubble is revealed. What will central banks do? Raise rates to combat inflation above the Platonic ideal of 2%? Cut rates to protect imploding asset prices they purport to care nothing about? We have no idea, nor do they. But if history is a guide, it will not end well. Picture a 100 foot tidal wave cresting just before the shore. We live in Indiana and although the ocean is 500 miles away, we are excellent surfers. After a largely dismal 2017 that caused us to feel somnambulant at times, we are looking forward to getting back in the water.

To our valued clients and friends, we are grateful for the opportunity to serve you. Please let us know if you have any questions regarding your portfolio.

Sincerely,

Mark M. Egan, CFA
Managing Director

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